

AR39

REPORT TO INVESTORS



MIDLAND-OSLER
SECURITIES LIMITED

We Recommend

December, 1967

File

HARVEY'S FOODS LIMITED

Common Shares

For Capital Appreciation

The common shares of Harvey's Foods Limited provide an excellent opportunity to participate in the rapidly expanding, limited menu, franchise restaurant industry in Canada. Harvey's management has developed an efficient and highly profitable franchise system in this field. The firm's name is well known in the Toronto, Montreal and other areas. Our recommendation is based on the following:

- Growth potential for limited menu restaurants in Canada is excellent
- Harvey's maintains high standards by exercising close control over suppliers and operators through frequent inspections
- Recent acquisition of the Swiss Chalet Bar-B-Q in Canada provides a new avenue for growth and profits. The contemplated future acquisition of Swiss Chalet Bar-B-Q Inc. will provide access to the U.S. market
- Company management is aggressive, resourceful and experienced. The Company's growth record has surpassed that achieved by leading U.S. restaurant chains
- Policy of owning land provides an attractive long term inflation hedge against rising rentals
- The shares have been approved for listing on the Toronto Stock Exchange and it is expected that they will be called for trading on December 5, 1967.

Recent Price : \$14.25

1967 Reported E.P.S. : \$ 0.43

1968 Estimated E.P.S. : \$ 0.82

Indicated Dividend : Nil

Price Range 1967 : \$15.75 - 3.75

P/E Ratio 1967 E.P.S. : 36.6x - 8.7x

P/E Ratio 1968 Est. E.P.S. : 19.2x - 4.6x

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CAPITAL STRUCTURE, October 30, 1967 (Pro Forma — year ends March 31)

Long Term Debt	\$3,286,000	41.8%
Preferred Stock	510,000	6.5
Common Equity	4,067,000	51.7
	<u>\$7,863,000</u>	<u>100.0%</u>

Preferred Stock: 10,000 5½% 1st preference shares of \$50 par value each are issued and outstanding of the 50,000 shares authorized. 10,400 2nd preference convertible shares of \$1 par value each are authorized, issued and outstanding.

Common equity: 861,154 common shares are issued and outstanding of the 2,000,000 shares authorized. Options on approximately 441,690 common shares are outstanding in the form of convertible preference shares, share purchase warrants and employee stock options. Thus, if all options and conversions were exercised, a total of 1,302,844 common shares would be issued. We estimate that the options on the 441,690 common shares will be exercised, 50,000 each year 1969 to 1973, 56,690 in 1974, 35,000 each year 1975 to 1977 and 30,000 in 1978.

INDUSTRY OUTLOOK

The growth potential for limited menu restaurants in Canada appears to be excellent based on the following factors:

- The make-up of the population is favourable for the industry
- The rural to urban movement of the population is continuing with 65% now located in cities
- The under 25 age group now comprises 50% of the population and is increasing. This group comprises 75% of the drive-in clientele
- Trend to shorter work weeks, more leisure time and increased affluence
- Increased mobility of the populace through increased auto ownership with more and better highways
- Trend of eating habits to prepared meals, come-as-you-are convenience and the popularity of taking the entire family out to dinner
- In the United States in 1965 there was one drive-in restaurant for about every 4,900 people. The growth in numbers of outlets and profits to leading drive-in chains continues. It is estimated that there was one drive-in for about every 35,000 people in the Metro Toronto area in 1967.

THE HARVEY'S CONCEPT

The Company franchises limited menu restaurants under the Harvey's name. A limited menu of hamburgers, hot dogs, french fries, milkshakes, soft drinks, milk, coffee and hot chocolate is served.

Four main factors contribute to the profitability of the Harvey's concept.

Experienced Management

The Chairman of the Board, Richard G. W. Mauran, has been associated with the restaurant and food industry for more than fifteen years. The Company's president, George B. Sukornyk, is a solicitor who has had many years of experience in land and site acquisitions before entering this industry in 1959.

High standards have been set for Harvey's restaurants. They are maintained through weekly visits by Company inspectors. A check list with a total of 500 possible penalty points is reviewed by the inspector on every visit. A warning letter is sent if 20 penalty points have been accumulated. If the defects have not been remedied within 5 days, the operator's franchise is automatically cancelled. Weekly and monthly reports on operations are also required from an operator.

Restaurant Site

Potential locations are carefully evaluated. A 33 point check list is used in the selection. Property investigations are carried out in most cases by Mr. Sukornyk and Mr. Mauran personally.

Harvey's restaurants are of simple design, with kitchen and serving areas merged. High quality building materials, such as quarry tiles for floors, stainless steel for counters and ceramic tile for walls, are utilized for ease of operation and maintenance. The Company's policy is to own the site or to lease with an option to purchase. Investors are therefore provided with an excellent long term inflation hedge through the ownership of land.

Operators

Franchise operators are carefully selected. The main considerations are age, marital status and previous employment. An operator receives four weeks' intensive training at Company expense in Toronto.

Management emphasizes the importance of people in their organization. They get to know their people, their special capabilities and they continually evaluate their potential for increased responsibility.

Food

All food products are prepared to Harvey's specifications in federally inspected plants. Food and supplies are contracted for with national firms and supplied to all franchise operators at national prices. The food cartons are date stamped by the supplier as a control to ensure freshness.

SWISS CHALET BAR-B-Q

The net assets of Swiss Chalet Bar-B-Q Limited were purchased from Mr. Mauran, effective June 19, 1967. These assets include five Swiss Chalet restaurants located in Toronto and Hamilton, the outstanding shares of Chalet Farms Limited and a modern office building located in Toronto. Swiss Chalet restaurants serve a limited menu of charcoal broiled chicken, french fries, salad, dessert and beverage. Each restaurant seats 185-235 people and two have banquet facilities for 125-200 people. Each has a take-out service, and a telephone order, home delivery service is provided in Toronto. The Harvey's franchising concept has been applied to the Swiss Chalet restaurants. Savings will result from the combined management and administration of Harvey's and Swiss Chalet restaurants. The contribution to income from Swiss Chalet restaurants is expected to be substantial.

Chalet Farms Limited operates a federally-inspected plant which processes chickens grown to its specifications. Swiss Chalet uses approximately 40% of Chalet Farms' production, the remaining 60% is sold to supermarkets and other users. Chalet Farms will contribute an estimated \$25,000 - 35,000 consolidated gross income.

SOURCES OF INCOME

Sale of franchises currently accounts for about 40% of gross income. A Harvey's franchise costs \$45,000 for a drive-in and \$55,000 for a sit-down operation. A new Swiss Chalet franchise will cost about \$200,000. Franchise fees are taken into income in the year of contract. A provision of 30% of unpaid franchise fees is provided to cover possible losses on collection and termination of franchise agreements. The Company experienced no losses to date.

Franchise commissions are paid by the operator on his gross sales. Suppliers' commissions are received on food and supplies purchased by operators. These commissions jointly account for roughly one third of gross income. Other sources of income are:

- Rental income from franchise operators less rental payments where the site is leased
- Interest on unpaid balance of franchise fees
- Profit from Company operation of a Harvey's and a Swiss Chalet which are used as training schools
- Profit of Chalet Farms Limited

FUTURE EXPANSION

The Company expects to have 50 restaurants in operation by March 31, 1968 including the 5 Swiss Chalet restaurants. Swiss Chalet Bar-B-Q Inc., with its two Swiss Chalet restaurants in Buffalo, N.Y., will be acquired as soon as financially possible. This chain would then be actively expanded in the United States. Increasing sales of existing units is also a factor in future growth.

Good sources of property for restaurant sites have been established in Toronto and Montreal. The Company expects to make satisfactory leasing arrangements in the future on about one half of all new outlets. A minimum of 15 Harvey's and 2 Swiss Chalet openings per year has been indicated by the Company for the next few years. We anticipate actual openings will surpass these minimum projections.

HIGHLIGHTS OF EARNINGS STATEMENT (000 omitted from \$ figures)

	Estimated	Actual			
	1968	1967	1966	1965	1964
Gross Income: Sales of Franchise	\$1,245	403	302	208	99
Other	\$1,389	620	358	181	70
	<u>\$2,634</u>	<u>1,023</u>	<u>660</u>	<u>389</u>	<u>169</u>
Net Earnings	\$ 723	272	176	96	28
Earnings per share	82¢	43	39	23	12
Number of locations in operation	50	32	22	14	7

COMPARISON OF GROWTH WITH U.S. COMPANIES (average compound annual growth rate in last 4 years)

	Harvey's Foods Limited	McDonald's Corporation	Hardee's Food Systems Inc.
Sales	82%	33%	53%
Net Income	127%	63%	66%
E/P/S	53%	38%	40%

CONCLUSION

Limited menu drive-in restaurants have an excellent future in Canada. Harvey's, by insisting on high standards in its restaurants, will continue to attract a large and profitable share of the market. Swiss Chalet restaurants enhance growth potential both in Canada and the United States. Accordingly, we foresee a continuation in Harvey's growth in the next few years.

The stock is currently trading 17.4 times estimated 1968 earnings. Continued success by Harvey's should increase this earnings multiple. The Toronto Stock Exchange listing will improve the marketability of the stock. Therefore, we recommend the purchase of common shares of Harvey's Foods Limited for excellent medium term growth.

Investment Research Reports

We have recently prepared the following studies which are available on request from our nearest branch office:

Thomson Newspapers Limited	Moore Corporation, Limited
Versatile Manufacturing Ltd.	Southam Press Limited
Shell Canada Limited	Denison Mines Limited
Standard Radio Limited	Canadian Pacific Railway Company
The Algoma Steel Corporation, Limited	Industrial Acceptance Corporation Limited
Dominion Stores Limited	

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